Supreme Court, U.S.
FILED
APR 19 2002
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No. 01-1393

In The
Supreme Court of the United States

DOUGLAS R. COLKITT,

Petitioner,

v.

GFL ADVANTAGE FUND, LTD.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION

PETER S. RUSS
(Counsel of Record)
BUCHANAN INGERSOLL
Professional Corporation
One Oxford Centre
301 Grant Street
20th Floor
Pittsburgh, PA 15219
(412) 562-8800

HOWARD I. BASHMAN
BUCHANAN INGERSOLL
Professional Corporation
Eleven Penn Center, 14th Floor
1835 Market Street
Philadelphia, PA 19103
(215) 665-8700

Counsel for Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

PARTIES TO THE PROCEEDING

The respondent in this matter is GFL Advantage Fund, Ltd. ("GFL"), a British Virgin Islands Limited Partnership. GFL has no parent companies or non-wholly owned subsidiaries to list pursuant to Rule 29.6.

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COUNTERSTATEMENT OF THE CASE

Overview

Neither of the two grounds advanced by petitioner Douglas R. Colkitt ("Colkitt") merits review by this Court. Colkitt first argues that the district court may not have possessed subject matter jurisdiction over the parties because of a recent split of authority among the circuits concerning the applicability of alienage diversity jurisdiction to citizens of United Kingdom Overseas Territories. Yet Colkitt's argument overlooks that the district court possessed subject matter jurisdiction on an alternative ground, independent of alienage diversity jurisdiction. Specifically, the district court also possessed federal question and supplemental jurisdiction under 28 U.S.C. §§ 1331 and 1367(a). Accordingly, even if this Court were to find that the district court did not possess alienage diversity jurisdiction as Colkitt suggests, the parties were nonetheless properly before the district court. Thus, Colkitt's first argument does not warrant review.

Colkitt's second argument is similarly unpersuasive. The district court's grant of summary judgment on Colkitt's securities fraud claim complied with pre-existing Third Circuit law, which was fully consistent with this Court's recent holding in *The Wharf (Holdings) Ltd. v. International Holdings, Inc.*, 532 U.S. 588 (2001). As a result, Colkitt's second basis for review likewise fails.

Factual and Procedural Background

This case involves two separate loans extended by GFL to Colkitt in 1996. In return for $13 million, Colkitt

executed two separate exchangeable notes (the "Notes") in favor of GFL in the face amounts of $3 million and $10 million. Under the terms of the Notes, Colkitt provided GFL with the right to exchange all or any part of the outstanding principal debt into shares of common stock owned by Colkitt in two public companies, National Medical Financial Services Corporation and EquiMed, Inc. The exchange price was set at an agreed upon discount against the future market price of these stocks.

The transactions were designed to take into account market fluctuation of the underlying stock during the terms of the loans. The number of shares of common stock GFL would receive in an exchange for debt was to be determined by the price of the common stock for the period immediately prior to the date of the exchange request. In other words, GFL was entitled to receive $1 worth of stock for every $1 of debt exchanged, regardless of the then-prevailing market price per share, as adjusted by the agreed upon discount.

Colkitt defaulted on his repayment obligations. GFL therefore filed suit against Colkitt in the United States District Court for the Middle District of Pennsylvania for breach of contract. Colkitt asserted various affirmative defenses and counterclaims against GFL, including claims brought under §§ 10(b) and 29(b) of the Securities Exchange Act of 1934 ("Exchange Act"), together with certain pendent state law counterclaims and defenses.

Colkitt's federal securities law counterclaims were twofold: a market manipulation claim and a securities fraud claim. Colkitt alleged that GFL manipulated the price of both securities through unlawful short selling

designed to artificially and temporarily depress the price of the underlying securities. Colkitt's securities fraud claim was derivative of his manipulation claim. Colkitt alleged that he was deceived in violation of § 10(b) of the Exchange Act as a result of GFL's failure to disclose its intent to sell short to depress price, either at the time the Notes were entered into or before the time GFL issued exchange requests.

Colkitt's manipulation claim and, hence, his deception claim as well are undermined by an incorrect factual premise that he repeats in his Petition. Colkitt asserts "there can be little dispute that Colkitt was misled as to the value of the notes by GFL's failure to disclose that it was short selling the stocks and depressing share prices, making the notes more costly to Colkitt by forcing him to sell additional shares to retire the same amount of debt." (Pet. 11). As noted above however, the Notes were structured so that GFL would receive a set dollar amount of stock in exchange for a set dollar amount of debt. The fact that GFL might receive a greater number of lesser-valued shares in no way renders the transaction more costly to Colkitt, nor does it confer to GFL an extra degree of profit.[1]

The District Court granted GFL's motion for summary judgment on July 17, 2000, awarding judgment in favor of GFL in the amount of $21,121,989.39. The Court of Appeals affirmed, rejecting Colkitt's manipulation claim on two grounds. First, it found that Colkitt had

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[1] Similarly, GFL would not have been adversely affected had it received fewer, more expensive shares for a set amount of debt exchanged in a rising market.

offered no evidence that GFL engaged in unlawful short sales because there is no evidence that the short selling injected inaccurate information into the marketplace or created artificial demand for the securities. *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 211 (3d Cir. 2001). Second, the appellate court held that Colkitt had also failed to meet the scienter requirement by failing to offer evidence that GFL engaged in short sales for the purpose of artificially depressing the prices of the underlying securities. *Id.*

The Court of Appeals also rejected Colkitt's security fraud claims on two independent grounds. First, Colkitt failed to present any evidence that GFL intended to engage in short sales at the time of the underlying loans. *Id.* at 213. Second, the appellate court ruled that GFL was under no duty to disclose to Colkitt any such intention to so engage in short selling. *Id.* at 214.

Colkitt's subsequent petition for rehearing and rehearing en banc was denied, without dissent.

ARGUMENT

I. When It Entered Judgment, The District Court Possessed Federal Question And Supplemental Jurisdiction Over The Claims In This Case, And Thus The Existence Or Nonexistence Of Alienage Diversity Jurisdiction Is Immaterial

In the first of two grounds presented for review, Colkitt asserts that if this Court affirms the Second Circuit's judgment in *Chase Manhattan Bank v. Traffic Stream (BVI) Infrastructure Ltd.*, No. 01-651 (argued April 17,

2002), then the judgment entered against him and in favor of respondent GFL, a British Virgin Islands limited partnership, would need to be vacated for lack of subject matter jurisdiction.

GFL respectfully submits that the Second Circuit's ruling in *Chase Manhattan Bank v. Traffic Stream* should be reversed for the reasons expressed in the merits briefs of petitioner Chase Manhattan Bank and in the amicus briefs in support of reversal that both the Solicitor General of the United States and the Government of the United Kingdom and Northern Ireland have filed.

Yet even if this Court were to affirm the Second Circuit's decision and hold that corporations organized and existing under the laws of United Kingdom Overseas Territories are not "citizens or subjects of a foreign state" for purposes of alienage diversity jurisdiction under 28 U.S.C. § 1332(a)(2), that result would not affect the outcome of GFL's suit against Colkitt. This is because the district court possessed subject matter jurisdiction on an entirely independent ground that will survive unaffected even if this Court affirms the Second Circuit's ruling in *Chase Manhattan Bank*.

Although Colkitt is correct that GFL initiated this suit in the United States District Court for the Middle District of Pennsylvania by invoking the district court's alienage diversity jurisdiction, Colkitt thereafter asserted various counterclaims arising under federal securities law. As the Third Circuit's decision makes clear, Colkitt's federal securities law counterclaims against GFL arose from the same transaction and occurrence as GFL's state law claims against Colkitt.

Colkitt's federal securities law counterclaims, which he is still seeking to have restored by means of the second question presented in the petition for writ of certiorari, conferred federal question jurisdiction on the District Court. *See* 28 U.S.C. § 1331 and 15 U.S.C. § 78aa. And, because GFL's original state law claims against Colkitt arose from the same transaction and occurrence as Colkitt's federal claims, the District Court possessed supplemental jurisdiction over GFL's state law claims. *See* 28 U.S.C. § 1367(a). Thus, when the District Court entered judgment in favor of GFL and against Colkitt on GFL's state law claims, the District Court possessed subject matter jurisdiction over those state law claims pursuant to both 28 U.S.C. § 1367(a) and 28 U.S.C. § 1332(a)(2).

Accordingly, even if this Court's decision in *Chase Manhattan Bank* were to deprive the District Court of subject matter jurisdiction under § 1332(a)(2), the *Chase Manhattan Bank* decision would not affect the continued existence of subject matter jurisdiction over GFL's state law claims pursuant to § 1367(a) arising from Colkitt's assertion of counterclaims predicated on federal securities law.

This Court has held that a post-judgment attack on a District Court's subject matter jurisdiction must establish, to succeed, that the District Court lacked subject matter jurisdiction at the time that it entered final judgment. *See Caterpillar Inc. v. Lewis*, 519 U.S. 61 (1996). As the Court explained:

> In this case, however, no jurisdictional defect lingered through judgment in the District Court. To wipe out the adjudication postjudgment, and return to state court a case now satisfying all

> federal jurisdictional requirements, would impose an exorbitant cost on our dual court system, a cost incompatible with the fair and unprotracted administration of justice.

Id. at 77.

In *Caterpillar*, this Court rejected a post-judgment jurisdictional attack brought against a final judgment entered in a case in which subject matter jurisdiction depended entirely on diversity of citizenship jurisdiction and in which complete diversity was lacking when the case arrived in federal court. *See id.* at 70-78. At the time of final judgment, however, diversity of citizenship jurisdiction existed, as the non-diverse plaintiff had previously been dismissed. *See id.* at 66-67. This Court held that because subject matter jurisdiction existed when the District Court entered its final judgment, the non-existence of subject matter jurisdiction when the case arrived in federal court was of no consequence. *See id.* at 75-78.

Although this Court's ruling in *Caterpillar* involved diversity of citizenship jurisdiction, the Second Circuit in *Fax Telecommunicationes Inc. v. AT&T*, 138 F.3d 479, 485-88 (2d Cir. 1998), ruled that the same result would apply where the defendant asserts a counterclaim furnishing federal question jurisdiction before the entry of final judgment in a suit in which no subject matter jurisdiction had previously existed. In *Fax Telecommunicationes*, the Second Circuit held that the defendant's assertion of a counterclaim arising under federal law gave the District Court subject matter jurisdiction over both the plaintiff's state law claims, as to which the trial court originally lacked subject matter jurisdiction, and the defendant's counterclaim. *See id.* at 488.

Colkitt's petition for writ of certiorari entirely ignores, and thus fails to challenge, the District Court's possession of federal question and supplemental jurisdiction over all claims and counterclaims in this case at the time final judgment was entered. Thus, even if this Court were to affirm the Second Circuit's decision in *Chase Manhattan Bank v. Traffic Stream*, that result would have no effect on the validity of GFL's judgment against Colkitt.

For these reasons, the first question presented in Colkitt's petition is unworthy of review.

II. The Third Circuit's Decision In This Case Does Not Conflict With This Court's Ruling In *The Wharf (Holdings) Ltd.* v. *United International Holdings, Inc.*

Colkitt also maintains that the Third Circuit's decision upholding the trial court's dismissal of his federal securities law fraud claims somehow conflicts with this Court's ruling in *The Wharf (Holdings) Ltd. v. United International Holdings, Inc.*, 532 U.S. 588 (2001).

Colkitt's discussion of this issue is improperly misleading insofar as it suggests that this Court's ruling in *The Wharf* issued after the Third Circuit's decision in Colkitt's case. *See* Petition at 9 ("The decision of the court of appeals is contrary to this Court's *subsequent* clarification of § 10(b) of the Exchange Act") (emphasis added). In fact, this Court issued its ruling in *The Wharf* on May 21, 2001, while the Third Circuit did not issue its opinion deciding Colkitt's appeal until November 16, 2001, almost six months later.

What Colkitt probably means is that this Court's decision in *The Wharf* issued after the parties had completed their briefing of the merits of Colkitt's appeal in the Third Circuit. However, Colkitt's argument that this Court's decision in *The Wharf* somehow controlled the issues pending for resolution in the Third Circuit is belied by the fact that Colkitt failed to file a Federal Rule of Appellate Procedure 28(j) letter drawing *The Wharf* decision to the attention of the three-judge panel assigned to decide his appeal.

Although Colkitt failed to bring *The Wharf* to the Third Circuit's attention in advance of its ruling on his appeal, Colkitt thereafter filed a petition for rehearing en banc that had as its primary focus the contention that the Third Circuit's decision conflicted with *The Wharf*. Tellingly, none of the ten non-recused active Third Circuit judges who considered Colkitt's rehearing petition, and neither of the two senior Third Circuit judges on the panel that decided his appeal, noted any dissent from the Third Circuit's order denying rehearing and rehearing en banc.

While Colkitt struggles to manufacture a conflict between this Court's decision in *The Wharf* and the Third Circuit's ruling, thereafter, on his appeal, no such conflict exists. Indeed, the aspect of this Court's holding in *The Wharf* that Colkitt alleges the Third Circuit ignored – that the sale of a security or option with the undisclosed intent not to honor a promise made in connection therewith can violate § 10(b) of the Securities Exchange Act of 1934 – simply reaffirms preexisting Third Circuit law. *See In re Phillips Petroleum Securities Litigation*, 881 F.2d 1236,

1245 & n.13 (3d Cir. 1989). The author of the Third Circuit's unanimous decision in *Phillips Petroleum* was the same judge who presided over the Third Circuit panel that unanimously decided, and rejected, Colkitt's appeal.

Before concluding, GFL must note that Colkitt's petition for writ of certiorari discloses one more reason why the supposed, but nonexistent, conflict between the Third Circuit's ruling in Colkitt's case and this Court's decision in *The Wharf* is undeserving of review. In footnote 1 of his petition, at page 12, Colkitt explains that "[a]s a possible alternate ground for decision, the court of appeals suggested that Colkitt failed to present evidence that GFL intended to engage in the short sales at the time of the notes." Colkitt then proceeds, in the text of that footnote, which spans more than one full page of his petition, to take issue with the factual predicate for the Third Circuit's alternate holding.

That the conflict Colkitt tries to manufacture between the Third Circuit's ruling in his case and this Court's decision in *The Wharf* is, by Colkitt's own admission, at most an alternate basis for the Third Circuit's affirmance of the dismissal of Colkitt's claims and defenses arising under federal securities law demonstrates beyond cavil that the second question presented does not qualify for this Court's review.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

PETER S. RUSS
(Counsel of Record)
BUCHANAN INGERSOLL
Professional Corporation
One Oxford Centre
301 Grant Street
20th Floor
Pittsburgh, PA 15219
(412) 562-8800

HOWARD J. BASHMAN
BUCHANAN INGERSOLL
Professional Corporation
Eleven Penn Center, 14th Floor
1835 Market Street
Philadelphia, PA 19103
(215) 665-8700

Counsel for Respondent